The Village at Westfield Topanga

Change or consolidate?

Shopping centres and, more generally retail, are undergoing something of a shift in the US. But where exactly are they headed, asks John Ryan?

THERE was a time in the US when developers built malls, people came and did some shopping, and profits were made. Those were halcyon days and mall builders, large and small, must have felt that as long as the bricks and mortar were in place, the good times would roll. That was, in fairness, a long time ago. Today matters are different. Consumers are choosier and retailers know exactly what they want and where they want to be. The cities that are growing fast in the US tend to be the favoured destinations for retailers and developers alike, with names such as Austin and Phoenix, among others, regularly produced as examples of where the money is headed. That said, according to California-based David Weinert, senior executive vice-president of leasing for Westfield's US operation, with just "one or two malls a year being built in the US", most of the development action could be more readily categorised as redevelopment activity. Westfield is, in fact, one of the few developers that will open a new mall next year, in New York's World Trade Center.

Put simply, prime malls remain desirable and malls in secondary locations may be so if they are capable of being upgraded, but there is a very sizable rump of existing retail assets for which alternative uses are being sought. Like all sweeping generalisations, however, this one is riddled with exceptions and some of these are reasonably substantial.

"For the better malls in the US, business has never been better," Weinert says, pointing to Westfield's latest results in the US, which show 6% growth in the last finan- >>

> "For the better malls in the US, business has never been better. Our focus is to develop nothing but flagship malls in the US and around the world"
>
> David Weinert

cial year. He adds: "Our focus is to develop nothing but flagship malls in the US and around the world."

In terms of Westfield's US activities, Weinert cites The Village at Westfield Topanga on the fringe of Los Angeles. "We've had excellent results here," he says. "It's a lifestyle shopping centre just across the road from a mall." He observes that, in the normal run of things, this would mean competition for the mall, but insists that the offer is complementary, rather than competitive. This may be so, but it is also very probably the case that, as one new mall opens or an old one is redeveloped, so another scheme sees a reduction in footfall.

Richard Latella, executive managing director of valuation and advisory at Cushman & Wakefield, notes that shopping centres in the US remain a competitive arena. There has been, he adds, a shift in emphasis, bringing new challenges for mall developers and operators: "In the urban areas, newer formats continue to find favour and the big boxes have responded by coming into the cities with smaller formats. The other thing that is having to be dealt with is 'showrooming' and the ability of retailers to respond to this."

In the cities, the new format phenomenon can be seen with the recent US debut of value-fashion retailer Primark. Latella says that the ability of new arrivals to work from a clean slate and move into properties that might not otherwise have been used puts them in a strong position. It also means that the urban landscap is altering. Primark opened in Boston in September and opens in seven further locations over the next 12 to 18 months, in spaces leased from Sears.

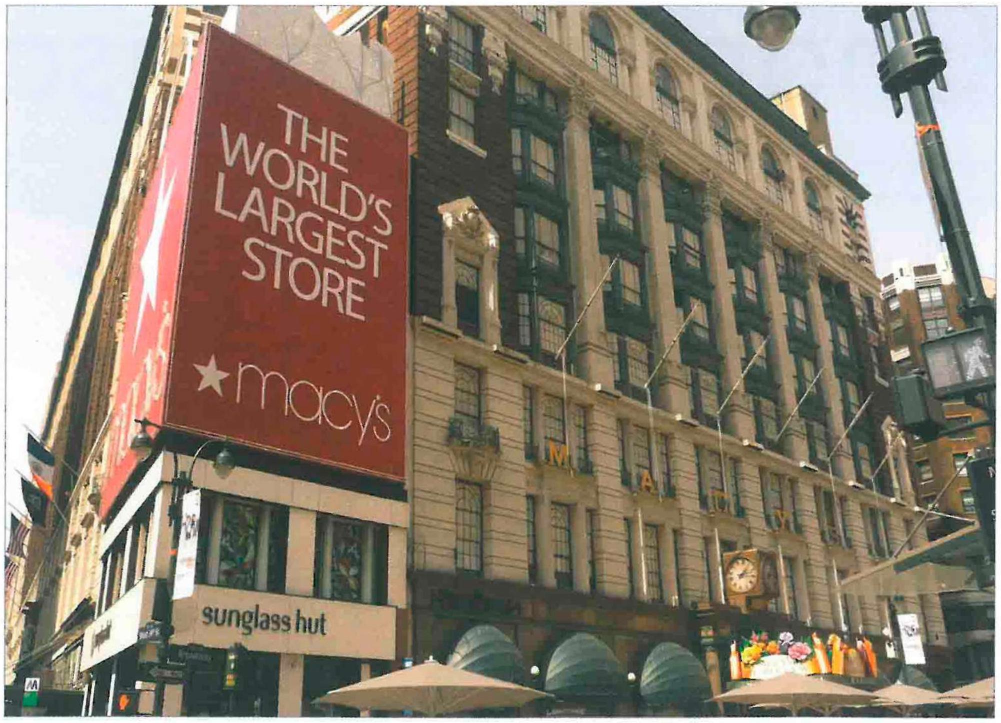
Primark's deal with Sears indicates the direction of travel for many of the more traditional US retailers (a substantial proportion of which are predominantly mall-based). Latella notes that Sears, which has had a torrid time for a number of years, has acted to try to turn things around: "They spun off about 200 stores into a REIT. They had a lot of department stores and department-store owners tend to be real estate rich. There has been a big push by retailers like this to monetise their real estate."

The Primark move is a prime example of this trend in action. Latella says that REITs have been rather more flexible and that, by moving stores into them, sub-lets have become more possible and other uses have been found for what might otherwise have been largely redundant portfolios.

When it comes to formats, department stores have had to shift with the times, Latella observes. "Stores that cater to everybody with everything have had to change quite a lot in the US," he says. Now, department stores are becoming more specialist and reinventing what they do in the cities, as well as heading out to the malls." He cites the Macy's flagship on New York's 34th Street as a case in point. "Over a five-year period, they have spent $500m," he says. "They have been aiming to rejuvenate the store by creating stores-in-store that address the needs of millennials."

Latella sees the lifestyle malls referenced by Weinert as something of a bandwagon on to which too many developers jumped: "As a sector it just got over-built." He cautions, however, that there is still room for this kind of mall in the "higher demographic areas". The problem, he adds, is that so many malls of this kind have been built that when "somebody went dark" (aka closed), other retailers would look for rent relief, as this would be deemed to be evidence that a mall was not working.

The shopping centres that are currently being built in the US tend to be 500,000 sq ft or more. This reflects the trend for building malls in locations to which people are moving and creating destinations based on breadth of choice and the inclusion of leisure. Simply by dint of their size, these schemes are more likely to be insulated from trouble, according to Latella, as well



Macy's on 34th Street, New York has invested $500m

"Stores that cater to everybody with everything have had to change quite a lot in the US"

Richard Latella

as from tenants that decide to call time on their leases.

Finally, mention should be made of outlet centres. Drive along almost any freeway in the US and it is an odds-on certainty that you will pass an outlet mall as you approach a major city. Latella says that the true outlet centres — those that acted as clearance locations for retail brands — "went away" and those that are left are in reality "premium label centres". Having survived the lean times in the last decade, these centres are stronger and look set to stay the course.

So where does this take the retail property sector and mall developers in the US?

Weinert says: "There has certainly been over-building in places, but there are a lot of retailers out there with OTB [open to buy] who have a hunger to expand." Noting that retailers such as Gap, Anne Taylor and J Crew are still "trying to figure out what they want to do about fashion", he says that the outlook remains generally positive.

The nature of anchor tenants is changing, too, according to Weinert: "Landlords are seriously looking at Eataly, among others, as an anchor." If this is the case, then the melding of leisure, dining and retail, which Eataly represents, is perhaps symptomatic of the shifting sands in mall occupation and tenant mix.

It would appear that the bad times for many mall developers are over, for the moment at least, but that does not mean that things are set fair in all quarters. The US, principally owing to its size and diversity, remains a country that has pockets of deep affluence alongside areas of grinding poverty. Mall construction, refurbishment and change are therefore a direct reflection of location. Much to play for, then, but a great deal depends on where you are and what you are building — or rebuilding. ■

WILL MACY'S TAKE THE REIT ROUTE?

US DEPARTMENT stores have been among the hardest hit businesses since online shopping started to dominate the consumer market. In an effort to boost declining revenues, some of the US' oldest retailers see their real estate as a solution.

Macy's may have to look to monetising its real estate soon. The mid-range department-store chain announced in early September that it would be shutting down about 5% of its stores — up to 40 — early next year. At the same time, it is holding on to billions of dollars' worth of real estate, and investors want a piece of the action that some of its competitors are seeing.

Last year, Sears — another staple US department store battling demographics and online retail — decided to spin its real estate holdings into a REIT, later named Seritage Growth Properties (SRG). The IPO was launched this July, when the REIT was valued at \$2.7bn. SRG was trading at \$38 per share after the market closed on September 28, down from the stock's peak of \$44.31 in mid-August. Because of the sale, Sears Holdings — the parent company resulting from the 2005 merger of Sears and US discount department store chain Kmart — and Sears Canada have posted profits since the spin-off, although sales have continued drop and it has continued to close stores.

Macy's is bigger than Sears and its New York City flagship store — valued at nearly \$4bn by its owner, Toronto-based Hudson's Bay Co — is likely worth more than all of Seritage's holdings combined. New investors into the publicly traded department store have suggested Macy's follow Sears' lead, because many of its stores are better located than Sears and Kmart properties, thus would provide a greater windfall for investors. But so far, the department store that markets itself as "magic" has decided that's a trick it is not yet ready to pull out of its sleeve.

Ethan Rothstein is Bisnow Media's lead DC commercial real estate reporter